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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission
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COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
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SUSAN BITTER SMITH

In the matter of: PATRICK LEONARD SHUDAK, a single man, PROMISE LAND PROPERTIES, LLC, an Arizona limited liability company, and PARKER SKYLAR & ASSOCIATES, LLC, an Arizona limited liability company, Respondents.	DOCKET NO. S-20859A-12-0413 **SECURITIES DIVISION'S POST-HEARING BRIEF** **Hearing Dates: June 17, 18 & 19, 2013** **Assigned to Administrative Law Judge Marc E. Stern**

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") submits its Post-Hearing Brief ("Brief") with respect to the administrative hearing held on June 17 – 19, 2013. This Brief is supported by the following Memorandum of Points and Authorities.

MEMORADUM OF POINTS AND AUTHORITIES

I. Procedural Background

On September 21, 2012, the Division filed a Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist, Order for Restitution, Order for Administrative Penalties, and Order for other Affirmative Action (the "Notice") against respondents Patrick Leonard Shudak, Promise Land Properties, LLC, and Parker Skylar & Associates, LLC, alleging multiple violations of the registration and antifraud provisions of the Arizona Securities Act ("Securities Act") in connection with the offer and sale of securities.

Promise Land failed to file an answer. On July 30, 2013, the Commission issued a default order, Decision #74015, against Promise Land. In Decision #74015, the Commission found that Promise Land had violated the registration provisions of the Securities Act and ordered Promise Land to pay restitution in the principal amount of $948,000 and a $25,000 administrative penalty.

Parker Skylar filed a request for a hearing on October 22, 2012. Parker Skylar's counsel subsequently withdrew and Parker Skylar did not file an answer. The Commission issued a default order, Decision #73784, against Parker Skylar on March 21, 2013. In Decision #73784, the Commission found that Parker Skylar issued and sold notes and investment contracts to investors within and from Arizona. This sale violated the registration provisions of the Securities Act. Parker Skylar also violated the antifraud provisions in connection with the offer and sale of securities by doing the following:

a) Selling membership interest that totaled more than 100%;

b) Representing to investors that all investor funds raised would be transferred to a developing entity—CC 1900 (described in detail below)—to be used for a specified real-estate development, when in fact, on several occasions, the money raised was not transferred to or used for the benefit of CC 1900;

c) Failing to disclose that a private lender—Nascent Investments, LLC (described in detail below)—had taken steps to perfect its security interest in all of Parker Skylar's assets and that the lender considered Parker Skylar in default of its obligations to the lender; and

d) Representing that Parker Skylar's manager, Shudak, was qualified and had expertise and experience to raise capital sufficient to fund CC 1900's operations while failing to disclose to several investors that several of Shudak's creditors had sued Shudak.

The Commission ordered Parker Skylar to pay restitution in the principal amount of $1,942,000 and an administrative penalty of $50,000.

Shudak filed a request for a hearing on October 22, 2012. Shudak filed his answer on

November 26, 2012. An administrative hearing to determine the violations and liability of Shudak individually and as the controlling person of Parker Skylar was held on June 17 – 19, 2013.

II. Jurisdiction

The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act. As stated in A.R.S. § 44-2032, the Commission has jurisdiction when it appears to the Commission that any person has engaged in any act, practice or transaction that constitutes a violation of the Securities Act or any rule or order of the Commission. If there is an unregistered, non-exempt offer or sale of securities within or from Arizona, or any fraud in connection with that offer or sale, that is a potential violation of the Securities Act and subject to the Commission's jurisdiction.[1]

III. Facts

Shudak was the financing arm of a residential development near Bisbee, AZ

Patrick Shudak is a single man who resided in Arizona during the years relevant to this action, i.e. throughout 2007 – 2009.[2] During this time period, the securities discussed below were issued and investor funds raised from the sale of the securities were used.

In early 2008, Shudak partnered with an Arizona real estate developer, Alan Thome, to develop a residential real estate development on 1900 acres of ranch land near Bisbee, Arizona (the "Bisbee Project").[3]

Shudak and Thome formed Cochise County 1900, LLC, an Arizona limited liability company ("CC 1900"). CC 1900 would acquire and hold title to the 1900 acres (the "Bisbee Property") and develop the Bisbee Project.[4]

Thome and Shudak—through their respective entities, Poncho Holdings, LLC and Parker Skylar (described in more detail below)—were the members of CC 1900. As shown in CC

[1] *See e.g.* A.R.S. § 44-1841, -1842 & -1991.
[2] H.T. p. 363:4 – 15; *See also* Ex. 6, bankruptcy schedules filed in 04/09/10 in Arizona District Court, where Shudak lists an Arizona address.
[3] Ex. S-14; *see also* H.T. p. 33:7 – 35:14.
[4] Ex. S-14, ¶ 1.5(A) at P00473.

1900's operating agreement, dated April 14, 2008, Shudak and Thome each owned a 50% interest in CC 1900.[5]

As CC 1900's manager, Thome was primarily responsible for the company's operations: obtaining entitlements and permits, entering construction contracts, and other work necessary for obtaining a final plat.[6]

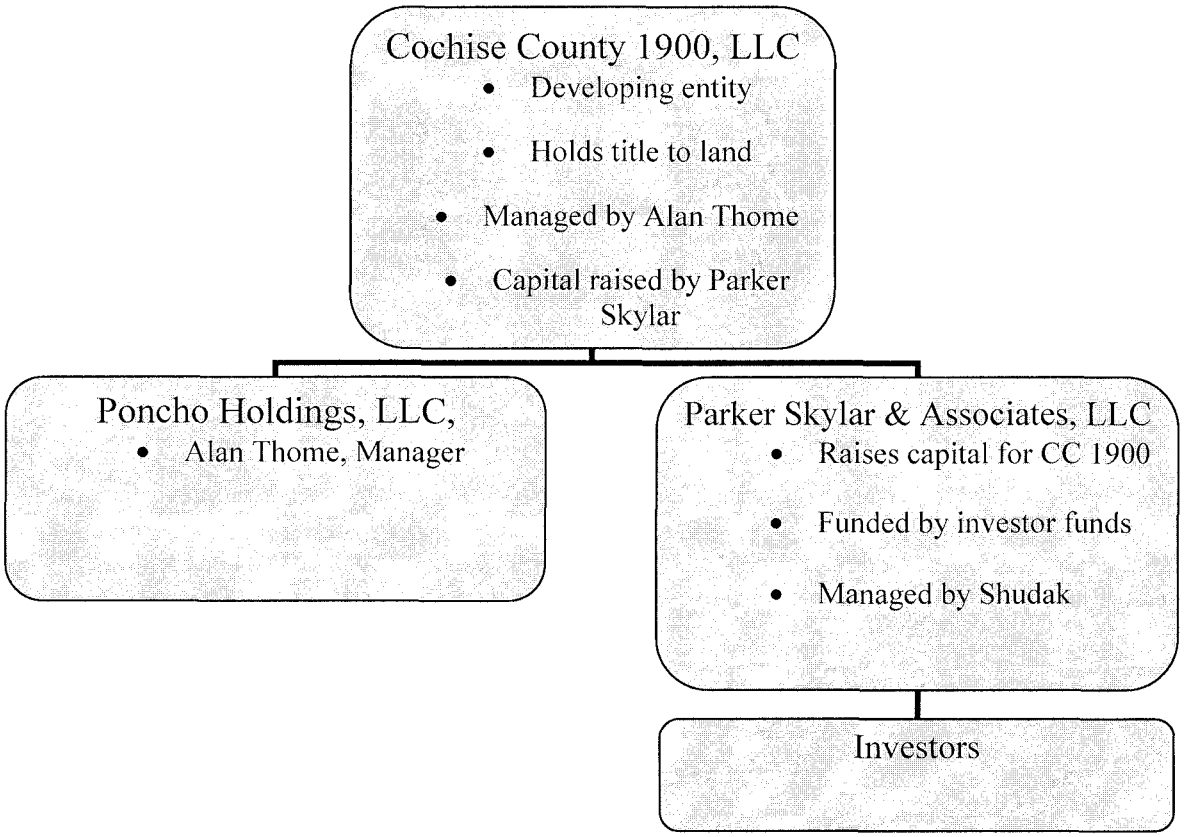
Shudak was the "money man"—i.e. the person responsible for obtaining capital for the Bisbee Project. During the hearing, investors Martin Schwank and Craig Swandal both testified that they understood that Shudak was to raise the money, while Thome was to handle the operations.[7] It is also possible that Shudak was involved in some of CC 1900's operations—such as purchasing the property and marketing.[8]

Shudak's role in CC 1900 was explicitly described in CC 1900's operating agreement, which states that Shudak was responsible for obtaining "debt financing" secured by the Bisbee Property. Shudak was also responsible for making additional capital contributions to CC 1900 in an amount not to exceed $2.5M.[9]

As described in CC 1900's operating agreement, the capital raised by Shudak was to be used for acquisition of the Bisbee Property, taxes, insurance, professional fees and other operating expenses related to obtaining a final plat for the Bisbee Property.[10] Shudak raised much of this capital from investors in Parker Skylar (described below), who expected that all of their funds would be used for this development and for no other purpose.[11]

[5] Ex. S-14 at P00472 & 505.
[6] Ex. S-14 at, e.g., P00478; *see also* H.T. p. 35:9 – 14.
[7] H.T. pp. 33:7 – 35:14, 196:5 – 11; 206:11 – 18.
[8] H.T. pp. 273:19 – 24; 341:2 – 19.
[9] Ex. S-14, ¶3.2(A) at P00484.
[10] *Id.*; *see also* discussion of "Investment Purchase Agreement" below.
[11] H.T. pp. 38:5 – 40:19; 199:13 – 201:17; 277:14 – 20; 376:22 – 377:5; 380:11 – 14.

This graph, based on the above facts, depicts the management structure of the Bisbee Project:



Secured loan from private lender for purchase of the Bisbee Property

On May 22, 2008, Parker Skylar obtained a short-term, high-interest, $250,000 loan from Nascent Investments, LLC, a private lender run by its manager, Eric Falbe.[12] As described in Section 2 of the "Loan and Security Agreement" for this loan, the proceeds from the loan were used to pay for the purchase of the Bisbee Property.[13] Parker Skylar granted Nascent a security interest in all of Parker Skylar's assets. Nascent took steps to perfect its security interest by filing a UCC-1 Financing Statement with the Arizona Secretary of State.[14]

In connection with this loan, Parker Skylar issued an "Assignment of Interest" which is substantially identical to the "Assignment of Interest" issued to each investor (described below).

[12] Ex. 15. *See also* H.T. pp. 368:13 – 371:19.
[13] Ex. 15 at ACC004633.
[14] Ex. 15 at ACC004628.

This particular Assignment transferred to Nascent a "twenty percent (20%) Percentage Interest" in Parker Skylar. This Assignment was signed by Shudak as manager of Parker Skylar.[15]

Shudak failed to inform subsequent Parker Skylar investors (described below) about this loan. At hearing, investor Martin Schwank testified that he first learned about this loan and Nascent's interest in Parker Skylar approximately two years after Schwank invested in Parker Skylar; Schwank learned about the loan from Nascent's manager, Eric Falbe.[16] An April 26, 2010 email from Falbe to Schwank substantiates Schwank's testimony.[17] Additionally, the Nascent loan is not disclosed in any investment documents provided to investors.[18]

In April, 2013 Nascent sued to enforce loan and security agreements. Shudak, Parker Skylar, and investor Martin Schwank, and all Parker Skylar investors are listed as defendants.[19] In its suit, Nascent claimed an interest in all of Parker Skylar's property as collateral for its loan and demands payment from all defendants.[20]

Raising capital by selling Notes and LLC membership interests to investors

Shudak obtained much of the capital for the Bisbee Project by soliciting people to invest in Parker Skylar.

On May 17, 2007, Shudak formed Parker Skylar as an Arizona limited liability company. From its formation to April 1, 2008, Parker Skylar was a member-managed LLC and Shudak was the sole member listed. An April 1, 2008 amendment to Parker Skylar's articles of organization made Parker Skylar a manager-managed company with Shudak as the manager.[21]

Shudak remained the only manager listed in Parker Skylar's articles. Shudak had control of Parker Skylar's bank accounts.[22] Shudak signed documents on behalf of Parker Skylar, including documents issued to Parker Skylar investors.[23] Parker Skylar had no other managers or

[15] Ex. 15 at ACC004647.
[16] H.T. pp. 69:15 – 71:3.
[17] Ex. 15 at ACC004627.
[18] Exs. S-16 – S-33.
[19] Ex. S-50.
[20] *Id.*
[21] Exs. S-5a & S-5b.
[22] Ex. S-52; H.T. pp. 300:10 – 301:22.
[23] *See e.g.* Exs. S-15 – S-33; *see also* H.T. p. 29:3 – 8.

employees; Parker Skylar held no member meetings and no management/operational decisions were ever submitted to members for a vote; members did not know who the other members were as Shudak did not disclose member lists (even after requests for such lists); and members did not receive any financial statements regarding Parker Skylar.[24]

Although at hearing Shudak produced an operating agreement for Parker Skylar—not signed by Shudak or any investors—that potentially allows for a salary, the investors who testified understood, based on Shudak's representations, that Shudak would not make money from a salary as a manager of Parker Skylar or from lending money to Parker Skylar. Investors Craig Swandal and Martin Schwank testified that Shudak described Shudak's compensation as coming on the "back end" i.e. distributions as a member of Parker Skylar.[25] In other words, as CC 1900 was profitable, it would make distributions to Parker Skylar. And Parker Skylar would in turn make distributions to its members, including Shudak.

As manager of Parker Skylar, Shudak began contacting potential Parker Skylar investors during or prior to January 2008. Several of these investors had no pre-existing relationship with Shudak. At the hearing, investor Craig Swandal testified that he found out about the potential investment through a friend who introduced Swandal to Shudak; Swandal had no pre-existing relationship with Shudak, much less one that would allow Shudak to ascertain Swandal's financial wherewithal.[26] Investor Steve Berendes testified that he met Shudak through a "friend of a friend" who merely introduced the two men, then let Shudak do all the talking about the investment.[27] Mr. Schwank testified that he introduced two investors—Jack Sandner and Craig Thompson—to Shudak, neither of which had a previous relationship with Shudak from which Shudak would be able to assess these two investors' suitability for the investment.[28] Investigator Morin testified that investor Gary Bates met Shudak through Shudak's Omaha-based friend.[29]

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[24] H.T. pp. 37:6 – 22; 66:11 – 67:10; 202:10 – 205:8; 205:13 – 206:7; 253:4 – 13.
[25] H.T. pp. 38:5 – 39:18; 199:13 – 201:17; 262:20 – 264:4.
[26] H.T. p. 193:3 – 20.
[27] H.T. pp. 272:15 – 273:9.
[28] H.T. pp. 36:21 – 37:5.
[29] H.T. p. 374:21 – 376:15.

All three witnesses testified that Shudak was the person that sold them the investment.[30] Berendes's contact with Shudak was so exclusive that Berendes thought he was investing with Shudak, not a separate entity.[31] The investor documents (described in more detail below) are consistent with the testimony: all of the investor documents in which Parker Skylar issues securities are signed by Shudak in his capacity as Parker Skylar's manager.[32]

Investors expected to earn a substantial return on their investment.[33] They did not expect to have any role in management or decision-making for the Bisbee Project.[34]

From January 2008 to July 2009, Shudak and Parker Skylar, within and from Arizona, sold Membership interests totaling 88% to 14 investors located in Arizona, Iowa, Minnesota and Nebraska (the "P-S Investors").[35] Four of these 14 investors invested through entities or trusts that they controlled.[36]

During this same timeframe, Shudak and Parker Skylar transferred Membership interests totaling 24.5% to four other persons who did not contribute cash in exchange for their Membership interests.[37] Thus, together with the 20% interest assigned to Nascent Investments, Parker Skylar/Shudak transferred a total of 132.5% of the company.

By December 21, 2008 at least 100% of the interests had been transferred. The sales after this date were in excess of 100%. The post-December sales included sales to at least five investors—Steve Berendes, Frank Moran, Tim Banghart, Mick Manley, William Livingston and Rosan Knapp/Gruetzemacher—for a total of at least $725,000.[38]

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[30] H.T. pp. 25:21 – 26:15, 32:19 – 33:13, 37:23 – 38:4, 156:16 – 157:25; 193:3 – 195:24; 218:21 – 220:2; 223:11 – 21; 281:20 – 283:12.
[31] H.T. p. 285:9 – 22.
[32] Exs. S-15 – S-33.
[33] H.T. pp. 32: 19 – 33:6; 265:1 – 266:1.
[34] H.T. pp. 35:15 – 36:20; 376:16 – 22.
[35] Exs. S-16, S-17, S-18, S-19, S-20, S-21, S-22, S-23, S-25, S-26, S-28, S-30, S-31, & S-32.
[36] If the trusts/entities are counted as separate investors, the total would go up to 17 investors. Since, however, the trusts/entities are mere extensions of an individual, the total number of cash investors who purchased membership interests is 14.
[37] Exs. S-20, S-24, S-27 & S-29; *see also* H.T. p. 386:2 – 23.
[38] Ex. S-48, which summarizes data from Exs. S-15 – S-33. The Ex. S-48 admitted at trial contains an inadvertent error: An entry of a 2% interest for Frank Lamer dated 8/18/08 (Ex. 20 at ACC002664) was included twice, while a 1.5% assignment to Lamer on 6/12/09 (Ex. 20 at ACC002667) was omitted. This changes the total percentage interests sold to 132.5% (rather than 133%). The other analysis of S-48, however, remains unchanged, i.e. that when Parker

The P-S Investors received documents from Parker Skylar, signed by Shudak, memorializing their investments with Parker Skylar.

Each investor received a document titled "Assignment of Interest" that identifies either Parker Skylar or Shudak as the "Grantor." Each Assignment clearly transfers a percentage, i.e. 1/100, of Parker Skylar with the following phrasing: "Grantor…hereby issues, sells, sets over, transfers, assigns and conveys to _____ ("Grantee") a _____ **percent** (__%) **Percentage** Interest as a Member of [Parker Skylar], an Arizona limited liability company[.]" (Emphasis added; the blanks were filled in with each respective Grantee's name and percent being assigned).[39]

Each Assignment acknowledges that Grantor has received "good and adequate consideration" from the respective Grantee. The Grantor further represents that the interest being transferred is "free and clear of any liens and encumbrances of any kind, character or nature and the Grantor, and its successors and assigns will forever warrant and defend the same against all lawful claims and demands whatsoever."[40]

Two of the P-S Investors, Tim Olp and Frank Lamer (through his entity, Frank & Associates, LLC), each invested $128,000 in Parker Skylar. In exchange for their investment, Olp and Lamer each received an "Assignment of Interest" (described above) and a document titled "Investment Agreement" executed by Shudak on behalf of Parker Skylar.[41] In their respective "Assignment[s] of Interest," Olp and Lamer were assigned 8% and 10% interests in Parker Skylar. Lamer later received assignments of interest of totaling 4.5%.

The Investment Agreement that Olp and Lamer received states that the terms of the agreement are legally binding in the State of Arizona. The investor funds are to be used as "earnest monies" for the purchase of the Bisbee Property, and that CC 1900 would be the

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Skylar sold a 2% interest to William C. Livingston on 12/21/08, a portion of that transfer exceeded 100% membership interests and all subsequent sales occurred when more than 100% interests had been transferred.

[39] *See, e.g.*, Ex. S-16 at ACC004510; *See also* H.T. p. 34:4 – 12 (Schwank testified that his understanding that each percentage point meant 1/100).

[40] Exs. S-16 – S-33.

[41] Exs. S-20 and S-26.

purchaser of the land. The investors were promised an 8% return on principal if CC 1900 did not close escrow on the Bisbee Property, and an $80,000 return if escrow closed. Both investors received a percentage interest in Parker Skylar—Olp received 8%, Lamer 10%. This entitled the investors to a percentage of Parker Skylar's profit, which Parker Skylar would receive as a 50% member of CC 1900.[42]

The remaining P-S Investors received an "Assignment of Interest" and two additional documents: an "Investment Purchase Agreement" and a Note. Shudak executed all of these documents on behalf of Parker Skylar.[43]

The "Investment Purchase Agreement" identifies each purchaser as the "Investor." It also defines the investment—"Unit(s)" consisting of an "interest-bearing Note" and a "one percent (1.00%) membership interest and distributive share in [Parker Skylar]"—as the "Securities."[44]

Section 1.1 of each "Investment Purchase Agreement" describes the investment as follows: "The Company [Parker Skylar] has been formed to engage in the business of real estate development involving the acquisition, financing, entitlement, development, subdivision, marketing and sale of real property, and portions or lots thereof, consisting of approximately 1,900 acres or ranch land (formerly known as the Flying H Ranch, located East [sic] of the City of Sierra Vista, Arizona, on Highway 92), in Cochise County, Arizona [], as a Member of Cochise County, 1900, LLC, an Arizona limited liability company[.]" Section 1.2 states that "In order to fund the Company, the investor desires to provide a portion of the needed capital...."[45]

Each Note issued by Parker Skylar contains a face value equal to the respective cash investment of the P-S Investor, bears 14%-per-annum interest, and provides for a balloon payment on or before a maturity date two years after the Note was made. Each Note states that it is being issued "for value received" and is being delivered in Scottsdale, Arizona and will be governed by the laws of the State of Arizona.[46]

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[42] *Id.*
[43] Exs. S-16, S-17, S-18, S-19, S-21, S-22, S-23, S-25, S-28, S-30, S-31, & S-32.
[44] *See e.g.* Ex. S-16 at ACC004506.
[45] Exs. S-16, S-17, S-18, S-19, S-21, S-22, S-23, S-25, S-28, S-30, S-31, & S-32.
[46] *Id.*

These Notes were made in addition to the assignment of the membership interests. And, as stated in each Investment Purchase Agreement, payment of the Note does not affect the membership interests held by the Note payee.[47]

As reflected in these Notes (and the other investor documents) the P-S Investors invested a total of $1,942,000 with Parker Skylar.

The vast majority of investor funds were pooled, then managed by Shudak

As shown and acknowledged by Shudak in the investor documents described above, the P-S Investors invested a total of approximately $1,942,000. The majority of P-S Investors paid for their investments with checks, cashier's checks, money orders or wire transfers payable to Shudak, Parker Skylar, an agent of Shudak, or a related, Shudak-controlled entity.[48]

In addition to acknowledging the payments in the investor documents, payment for the investments was confirmed by the Division's accountant, Andrea McDermitt-Fields, who testified that payments totaling $1,675,000 from the P-S Investors were deposited directly into Parker Skylar's bank account in the timeframe reviewed, i.e. January 1, 2008 through 2010.[49] An additional $101,000 from Tim Olp appears in bank records prior to the review period.[50]

Copies of checks and wire-transfer information from Frank Lamer, Gary Bates, and Steve Berendes[51] (along with Berendes's testimony[52]) establish additional payments of $175,000. Testimony from Investigator Morin established that investor Jerry Gruetzemacher and his wife Rosan Knapp made their $100,000 payment to CC 1900 through attorney Dan Curtis.[53]

Further corroboration of investment amounts is found in Shudak's bankruptcy schedules. In these schedules, admitted into evidence as Ex. S-6, all the P-S Investors except Olp and Lamer are listed as unsecured creditors.[54] The amounts owed to these "unsecured creditors" accurately

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[47] *Id.*
[48] Exs. S-53, S-57, & S-58.
[49] Ex. S-57; H.T. pp. 304:19 – 306:21, 308:14 – 309:5.
[50] Exs. S-57 and S-53.
[51] Ex. S-58.
[52] H.T. p. 290:10 – 13.
[53] H.T. pp. 379:23 – 380:10.
[54] Ex. S-6. P-S Investors are listed as "Cochise County Land Investors." Investors listed include Martin Schwank ($310,000) and Schwank's entities Ash Ali Holdings ($50,000) and LindaMar Holdings ($310,000); Bill Livingston

reflect the amounts shown as the purchase price in the investment documents for each investor, with two exceptions: (i) Martin Schwank is listed as a creditor owed $360,000 total, in fact Schwank invested $361,000; and (ii) Tim Banghart, whose investment documents total $175,000, but Banghart is listed as a creditor owed $200,000 in the bankruptcy schedules.[55]

In sum, additional documents and testimony add further confirmation that the investors paid the amounts shown in their investor documents. Moreover, the vast majority of these funds were pooled together in a single bank account controlled by Shudak where they were to be used in for development of the Bisbee Project.

The offering was made to unaccredited investors

The evidence at hearing established that Berendes[56] and Gruetzemacher/Knapp[57] were not accredited investors when they were solicited and sold the Parker Skylar investments. At hearing, Shudak did not present any evidence that any of the investors were accredited. The Division provided each "Investor Suitability Questionnaire" in its possession, namely Questionnaires signed by Banghart, Bates, Lane, Livingston, and Sandner.[58] There were no documents specifying the means by which the remaining investors could be considered accredited. Furthermore, Shudak presented no evidence that anyone at Parker Skylar had reviewed the few, signed representations of accreditation to make sure they were properly completed and received for each investor.

Additional Note issued by Shudak as an investment in Parker Skylar

On July 15, 2009, Shudak issued a note to Donald Van Hook in the principal amount of $200,000. As Investigator Morin testified, Van Hook invested expecting his money would be used for development of the Bisbee Project.[59]

($150,000); Craig Swandal ($300,000); Craig Thompson ($25,000); Frank Moran ($50,000); Gary Bates ($25,000); Jack Sander ($25,000); Jerry Gruetzemacher ($100,000); Mick Manley ($350,000); Mitch Lane ($25,000); Steve Berendes ($100,000); Tim Banghart ($200,000).

[55] Ex. 6 at pp. 15, 24, 25 & 31.

[56] H.T. pp. 278:20 – 279:9.

[57] H.T. p. 381:4 – 12.

[58] Exs. S-16, S-17, S-21, S-22, and S-28.

[59] H.T. p. 381:25 – 383:3.

To induce Van Hook to accept this $200,000 note, Shudak provided Van Hook with an agreement titled "Collateral Assignment of Member's Interest in Limited Liability Company." The collateral assignment states that, to induce the holders to accept the note, Shudak agreed to grant Van Hook a security interest in and to 50% of Parker Skylar.

At the time this note and collateral assignment were executed, however, Parker Skylar and Shudak had already transferred membership interests totaling at least 132.5%.[60]

Misuse of investor funds

As noted above, investors understood that their funds would be used only for purchase and development of the Bisbee Property. They did not expect Shudak to take a salary or pay his related entities. In spite of these representations and in spite of Parker Skylar not generating any profits, on several occasions Shudak made transfers of investor funds that did not benefit CC 1900 or development of the Bisbee Project. For example:

a) At the beginning of April 2008, Parker Skylar's bank account had a balance of less than $100. During that month, P-S Investor funds totaling approximately $300,000 were deposited in the bank account. During that month, Shudak caused $190,000 to be transferred to his personal account and $100,000 to be transferred to Kathy Shudak, Shudak's ex-wife.[61]

b) At the beginning of August 2008, Parker Skylar's bank account had a balance of less than $1,000. During that month investor funds totaling approximately $325,000 were deposited in the account. During this month, Parker Skylar transferred approximately $68,000 to Shudak; $50,000 to Cochise County Land, LLC; $6,000 to a printing business owned by Shudak; $14,000 to Promise Land Properties, LLC; and approximately $30,000 to two churches.[62]

[60] Ex. S-48.
[61] Ex. S-36; H.T. pp. 309:19 – 311:19; 315:16 – 3:17:6.
[62] Ex. S-38.

Lawsuits against Shudak by his creditors

As discussed above, Shudak represented that he was capable of raising capital for a significant residential real estate development. For example, the CC 1900 operating agreement states that Shudak is responsible for raising capital to fund CC 1900's expenses for obtaining entitlements for the Bisbee Project and that Shudak will "bear the economic burden of discharging such costs [for obtaining entitlements] and related to [CC 1900] liabilities and the total risk of economic loss with respect to the Entitlement Phase Financing Costs."[63]

While soliciting the P-S Investors, Shudak failed to inform potential investors that several of Shudak's creditors were suing Shudak, with the earliest such lawsuit being filed on July 8, 2008 and the earliest judgment being ordered on February 24, 2009. These lawsuits include the following cases in Maricopa County Superior Court.

- CV2008-015975, filed on July 8, 2008. The court awarded plaintiff Marshall & Ilsley Bank a default judgment against Shudak in the principal amount of $154,278.53 on December 23, 2008, and an additional $49,643.86 on January 6, 2009.[64]
- CV2008-021639, filed on September 8, 2008. The court awarded plaintiff Marshall & Ilsley Bank a default judgment against Shudak on March 6, 2009, in the principal amount of $43,744.47.[65]
- CV2008-022801, filed on September 17, 2008. The court awarded plaintiff Marshall & Ilsley Bank a default judgment against Shudak on June 10, 2009, in the principal amount of $356,985.54.[66]
- CV2008-027952, filed on November 18, 2008. The court awarded plaintiff JP Morgan Chase a default judgment against Shudak on February 24, 2009, in the principal amount of $99,157.67.[67]

[63] Ex. S-14 at P00484.
[64] Ex. S-40.
[65] Ex. S-41.
[66] Ex. S-42.
[67] Ex. S-43.

Only three investors—Lamer, Olp and Swandal—invested prior to July 8, 2008. And several investors—Manley, Livingston, Gruetzemacher—invested after the February 24, 2009 judgment had been entered in one of the suits.[68] These court cases were not disclosed in the investor documents of investors who purchased after the cases had been filed.[69] Investor Craig Swandal testified that investors became aware of these court cases much later after they invested.[70]

Current status of the Bisbee Project.

The Bisbee Property is currently for sale, and is subject to being foreclosed on due to a missed lump-sum payment of $970,000 on the loan to purchase the property.[71] As noted above, the investors did not intend to have any role in managing the Bisbee Project; they had no real estate development or finance experience.[72] The development's failure and almost-certain foreclosure confirm this lack of experience.

IV. Legal Argument

The Division established at hearing that, starting in January 2008 through at least July 2009, respondents Shudak and Parker Skylar repeatedly offered and sold notes and investment contracts in the form of LLC membership interests issued by Parker Skylar. Both the notes and the investment contracts fall squarely within the definition of securities under the Securities Act.

A. The Notes offered and sold by Parker Skylar are securities.

The Securities Act, in A.R.S. § 44-1841, provides that a security may not be sold in Arizona unless it is registered with the Commission. As defined in A.R.S. § 44-1801(26), "any note" is a security. Arizona courts have developed two separate approaches in distinguishing between security and non-security notes under the Securities Act. The analysis used depends upon whether the issue is the violation of the registration provisions or the violation of antifraud provisions of the Securities Act.

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[68] Ex. S-19, S-22 & S-23.
[69] Exs. S-16 – S-33.
[70] H.T. pp. 261:9 – 262:1.
[71] H.T. pp. 76:18 – 79:5.
[72] H.T. pp. 158:1 – 160:19.

The Notes are securities for purposes of Securities Act registration requirements

In *State v. Tober*, the Arizona Supreme Court held that the Securities Act provided a clear definition of the term "note" with the words "any note."[73] Therefore, the Court had no reason to use any of the tests fashioned by the federal courts for determining whether a particular note was a security for purposes of registration.[74] The Court held that all notes are securities that must be registered with the Commission unless an exemption applies.

In this case, Parker Skylar labeled its notes as "Notes" and further identified these Notes as "Securities" in documents provided to investors. The Notes provide for payment of 14% interest and a balloon payment after a two-year term. Thus the Notes clearly meet the definition of "any note" and are subject to the registration requirements unless an exemption applies. As stated in A.R.S. § 44-2033, it is the respondent's burden to show that an exemption applies. Shudak presented no evidence that any exemption that would apply to these Notes. Accordingly, the Notes are securities for purposes of the registration provisions of the Securities Act.

The Notes are securities for purposes of the Securities Act antifraud provisions

When determining whether a note is a security for purposes of the Securities Act antifraud provisions, Arizona courts apply the "family resemblance" test articulated by the U.S. Supreme Court in *Reves v. Ernst & Young*.[75] Arizona's use of this separate test for antifraud purposes was explained by the appellate court in *MacCollum v. Perkinson*[76] which used the *Reves* test after concluding that the definition of security was not the same for purposes of the registration and the antifraud provisions of the Securities Act.

The *Reves* analysis starts with the presumption that notes are securities.[77] This presumption may be rebutted only by showing that the note bears a strong resemblance, determined by examining four specified factors, to one of a judicially crafted list of categories of instruments that are not securities (these categories include, for example, notes delivered in consumer financing, notes secured

[73] 173 Ariz. at 211, 841 P.2d 206 (1992).
[74] *Tober*, 173 Ariz. at 213, 213 841 P.2d at 208.
[75] 494 U.S. 56 (1990).
[76] 185 Ariz. 179, 185, 913 P.2d 1097, 1103 (App. 1996).
[77] *Reves*, 494 U.S. at 65.

by a mortgage, and certain other short-term notes).[78] If an instrument is not sufficiently similar to a listed item, the court must decide whether another category should be added by examining these same factors.[79] Failure to satisfy one of the factors is not dispositive; they are considered as a whole.[80]

The first *Reves* factor is to assess the motivations of the buyer and seller to enter into the transaction at issue. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a security.[81] Here, the seller's motivation to raise money is explicitly stated in the "Investment Purchase Agreement" given to investors: Parker Skylar, as a member of CC 1900, was formed to engage in the business of real estate development of the Bisbee Property. The investor is investing "In order to fund the Company" and "to provide a portion of the needed capital...."[82] As noted above, the investors purchased the Notes with the expectation of a substantial return on their investment. Thus, under the first factor of the *Reves* test, the Notes are securities.

The second factor is the plan of distribution, which must be examined to determine if the "note" is an instrument in which there is "common trading for speculation or investment."[83] When discussing this factor, the *MacCollum* court noted that "Offering and selling to a broad segment of the public is all that is required to establish the requisite 'common trading' in an instrument."[84] When defining common trading, in *Stoiber v. S.E.C.*, the D.C. Circuit Court considered the fact that individuals, as opposed to financial institutions, were solicited, and found the common trading element was satisfied.[85] Here, the Notes were sold to the public at large. Shudak met with and

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[78] 494 U.S. at 65.
[79] *Id.*
[80] *See MacNabb*, 298 F.3d at 1132-33 (holding that, although the third factor supported neither side's position, the notes in question nevertheless constituted securities).
[81] *Reves*, 494 U.S. at 66-67.
[82] Exs. S-16, S-17, S-18, S-19, S-21, S-22, S-23, S-25, S-28, S-30, S-31, & S-32.
[83] *Reves*, 494 U.S. at 68-69.
[84] 185 Ariz. at 187, 913 P.2d at 1105 quoting *Reves*, 494 U.S. at 68, and citing *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 694 (1985) (stock of closely held corporation not traded on any exchange held to be a security).
[85] 161 F.3d 745, 751 (D.C. Cir. 1998); *see also S.E.C. v. Global Telecom Services, L.L.C.*, 325 F.Supp. 2d 94 (D.Conn. 2004) (stating that the broad sale to the public factor must be weighed against the purchaser's need for protection and noting that where notes are sold to individuals rather than sophisticated institutions, common trading has been found).

sold Notes to individuals who had no relationship with Shudak and only heard of the investment through friends. There is no record that Shudak ever refused to meet with any individual who expressed interest and was able to meet with Shudak. There is also no evidence that any of the individual investors were sophisticated. And no financial institutions purchased the Notes. As a result, under the second *Reves* factor, the Notes are securities.

The third factor is to examine the reasonable expectations of the investment public.[86] This factor, which is "closely related" to the first factor,[87] accounts for "whether a reasonable member of the investing public would consider these notes as investments."[88] Particularly when the promoters characterize the notes as "investments" it is "reasonable for a prospective purchaser to take [the promoters] at [their] word."[89] This is exactly what occurred here. The Notes were described in an agreement titled "*Investment* Purchase Agreement" and the purchaser was described as the investor. In this same document, the Notes were defined as "Securities." The purchasers bought the Notes expecting a 14% return after a two-year period. As a result, the Notes were securities under the third *Reves* factor.

The fourth and final factor is whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the securities laws unnecessary.[90] There are no risk-reducing factors that would obviate the need for the securities laws to apply. The record is void of any evidence identifying any "risk-reducing factor to suggest that these instruments [Notes] are not in fact securities."[91] Consequently, under the fourth *Reves* factor, the Notes are securities.

The Notes do not resemble any of the categories of non-security notes enumerated in Reves. Furthermore, application the four factors shows that the Notes do not bear a family

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[86] *Reves*, 494 U.S. at 68.
[87] *S.E.C v. J.T. Wallenbrock & Associates*, 313 F.3d 531, 539 (9th Cir. 2002).
[88] *McNabb v. SEC*, 298 F.3d 1126, 1132 (9th Cir. 2002).
[89] *Reves*, 494 U.S. at 69.
[90] *Reves*, 494 U.S. at 68; *see also MacNabb v. S.E.C.*, 298 F.3d 1126 (9th Cir. 2002).
[91] *Id.*

resemblance to any of the recognized non-securities and should not be added as an additional category of non-security notes.

Consequently, the Notes are securities for purposes of the antifraud provisions of the Securities Act.

B. The LLC membership interests are securities in the form of investment contracts.

In *Nutek Info Sys., Inc. v. Arizona Corp. Comm'n*, the Arizona Supreme Court held that membership interests in an LLC are securities where the management structure of an LLC prevents the members from exercising effective control of the LLC.[92] In *Nutek*, the LLC members of a member-managed LLC signed a management agreement that turned over all principal management functions to another party.[93] Members had "little to no input" on the agreements that the LLC entered into.[94] Additionally, the court found that the members could not exercise effective control of the business as a practical matter because of the large number of geographically disbursed members.[95] Nutek also found it significant that the members lacked the technical expertise to operate the business.[96]

Here, the Parker Skylar investors were members of Parker Skylar, a *manager*-managed LLC, which controlled the use and spending of investor funds. Parker Skylar, in turn, was a member of CC 1900, another *manager*-managed LLC, which handled most of the day-to-day operations of the Bisbee Project. The Parker Skylar investors had no legal rights to exercise control of their funds or operations of the Bisbee Project. And, while members of Parker Skylar, they did not in fact exercise any control: there were no membership meetings and no matters were put to a vote of the members. The members were also geographically disbursed and did not know who the other members were. As a result, they could not, as a practical matter, exercise any control over Parker Skylar and its operations. Finally, the members lacked real estate investment and development experience. Consequently, the Parker Skylar investors had even

[92] 194 Ariz. 104, 108, 977 P.2d 826, 830 (App. 1998).
[93] 194 Ariz. at 109-110, 977 P.2d at 831-832.
[94] *Id.* at 110, 832.
[95] *Id.*
[96] *Id.*

less control of their investment than the *Nutek* investors. As a result, under the standards of *Nutek*, the Parker Skylar membership interests are securities.

The *Nutek* Court also reached its conclusion that LLC membership interests are investment contracts by using the test set forth in *S.E.C. v. W.J. Howey Co.*[97] Under the *Howey* test, an investment contract exists if it involves the following three elements: (1) an investment of money or other consideration; (2) in a common enterprise; (3) with the expectation of profits earned solely from the efforts of the promoter or a thirty party.[98]

The first prong of *Howey* has been established – an investment of money. Parker Skylar, through Shudak, sought and obtained an investment of money from investors. As described above, investor documents, bank records, copies of checks and wire transfer information, bankruptcy schedules, and testimony establish that investors paid money to Parker Skylar. The vast majority of this money was directly deposited into Parker Skylar's bank account. Thus, the investors paid money in exchange for their LLC membership interests.

The second prong of *Howey*, investing in a common enterprise, is also satisfied. With respect to this prong, "Two tests have been developed to determine the existence of a common enterprise in order to satisfy the second prong of the *Howey* test: (1) the horizontal commonality test and (2) the vertical commonality test."[99] Arizona courts have held that commonality will be satisfied if either horizontal or vertical commonality can be shown.[100]

Horizontal commonality "requires a pooling of investor funds collectively managed by a promoter or third party."[101] Here, there was horizontal commonality because, as described above, the funds of multiple Parker Skylar investors were pooled—mostly into a single bank account—to fund the Bisbee Project.

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[97] 328 U.S. 293, 298 (1946).
[98] 328 U.S. at 298; *see also Rose v. Dobras*, 128 Ariz. 209, 211, 624 P.2d 887, 889 (App. 1981)
[99] *Daggett v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 565, 733 P.2d 1142, 1148 (App. 1986).
[100] *Daggett*, 152 Ariz. at 566, 733 P.2d at 1149.
[101] *Daggett*, 152 Ariz. at 565, 733 P.2d at 1148.

There was also vertical commonality, which requires a positive correlation between the potential profits of the investor and the potential profits of the promoter.[102] Here, Parker Skylar, Shudak and the investors were all to be paid from profits generated by the Bisbee Project. Thus, the Parker Skylar investment satisfies both vertical and horizontal commonality.

The final prong of *Howey*—efforts of others—is interpreted by the holding in *SEC v. Glenn W. Turner Enterprises* in which the Ninth Circuit concluded that the test is "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."[103]

In this case, as discussed above, the Parker Skylar investment was promoted to investors as a passive investment. Investors testified that they did not expect to have any management role. Nor did they ever manage Parker Skylar. During the relevant time period, 2008 through 2010, investors did not participate in any management meetings, did not vote on any decisions related to the Bisbee Project and were only once informed of a potential—though unsubstantiated—offer to purchase the 1900 acres. On a practical level, the members of Parker Skylar could not manage Parker Skylar: they did not know who the other members were and they lacked technical expertise related to real estate development. Events subsequent to Shudak resigning as Parker Skylar's management establish this lack of ability to manage and lack of expertise. In order to exercise any control of their investment, the investors had to put forth a herculean effort which involved locating the other investors, retaining experts, and restructuring the ownership/entity structures. These facts establish that the third element of the *Howey* test is met.

As a result, the LLC memberships in Parker Skylar constitute securities in the form an investment contract.

C. Parker Skylar and Shudak sold unregistered securities as unregistered dealers and salesmen.

[102] *See Daggett*, 152 Ariz. at 566, 733 P.2d at 1149; *Vairo v. Clayden*, 153 Ariz. 13, 17, 734 P.2d 110, 114 (App. 1987); *Foy v. Thorp*, 186 Ariz. 151, 158, 920 P.2d 31, 38 (App. 1996).
[103] 474 F.2d 476, 482 (9th Cir. 1973).

The Parker Skylar notes and investment contracts were offered and sold within or from Arizona in violation of A.R.S. § 44-1841 and § 44-1842 of the Securities Act. Parker Skylar and Shudak were both located in Arizona while the securities were being issued. The Notes say that they were delivered in Scottsdale, Arizona and that the notes are governed by Arizona law.

The Securities Act, A.R.S. § 44-1841, provides that a security may not be offered or sold in or from Arizona unless it is registered with the Commission. Additionally, A.R.S. § 44-1842 requires that a person who sells or offers to sell securities in or from Arizona must be registered as a dealer or salesman with the Commission. The evidence produced at hearing established that Parker Skylar and Shudak violated A.R.S. § 44-1841 and § 1842 with numerous offers and sales of unregistered securities. Pursuant to A.R.S. § 44-2034, the Division presented certificates of non-registration for all respondents for the relevant time period.[104]

Thus, Parker Skylar and Shudak were not registered as dealers or salesmen in Arizona during the relevant time. The offer and sale of these securities violated the Securities Act.

D. Parker Skylar and Shudak committed fraud in the offer and sale of securities.

The Division alleged and established at hearing that respondents violated the antifraud provision of the Securities Act, A.R.S. § 44-1991. Under A.R.S. § 44-1991(A)(2), in connection with the sale of securities, it is a fraud to "[m]ake any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading."

The standard of materiality is whether a reasonable investor would have wanted to know the omitted facts.[105] In the context of these provisions, the term "material" requires a showing of substantial likelihood that, under all the circumstances, the misstated or omitted fact would have assumed actual significance in the deliberations of a reasonable investor.[106] There is an affirmative

[104] Ex. S-1 – S-3.
[105] *See Rose*, 128 Ariz. at 214, 624 P.2d at 892.
[106] *See Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131, 1136 (1986) *citing Rose*, 128 Ariz. at 214, 624 P.2d at 892 (*quoting TSC Industries v. Northway, Inc.*, 426 U.S. 438 (1976)).

duty not to mislead potential investors in any way—a heavy burden on the offeror. And the investor is not required to investigate or act with due diligence.[107]

Additionally, a misrepresentation or omission of a material fact in the offer and sale of a security is actionable even though it may be unintended or the falsity or misleading character of the statement may be unknown. In other words, scienter or guilty knowledge is not an element of a violation of A.R.S. § 44-1991.[108] Stated differently, a seller of securities is strictly liable for any of the misrepresentations or omissions he makes.[109] Unlike common law fraud, reliance upon a misrepresentation is not an element in fraud involving the offer or sale of securities.

The evidence elicited at hearing clearly establishes four frauds committed by Parker Skylar and Shudak in connection with the offer or sale of the Parker Skylar investments.

First, Parker Skylar issued membership interests totaling 132.5% of the company. In the assignments given to purchasers, it was clear that each unit purchased was 1/100: the term "percent" was used, and the symbol "%" was next to the number. Martin Schwank further testified that he understood one unit to be 1/100. Not 1/132.5%. As a result, calling a membership interest a "percent" is misleading. Since only Shudak knew what investments were being sold, only he could have done the very simple math required to count to 100. His failure to do this is, at best, reckless. Since selling more than 100% affects what an investor is actually purchasing and affects the rights an investor would have to any returns, selling more than 100% is material information; not disclosing it constitutes fraud.

The second fraud is omitting information about Parker Skylar's loan to Nascent Investments. As described above, Nascent was granted a security interest in all of Parker Skylar's assets and took steps to perfect that interest. This was not disclosed to investors. In fact, Parker Skylar made representations that there were no liens of any kind on membership interests. Thus, investors did not know of a potential lawsuit or adverse claim to the interests they purchased. A threat of expensive lawsuits that could result in losing the entire investment would affect a reasonable person's decision

[107] *Id.*
[108] *See e.g. State v. Gunnison*, 127 Ariz. 110, 113, 618 P.2d 604, 607 (1980).
[109] *See Rose*, 128 Ariz. at 214, 624 P.2d at 892.

to invest. Consequently, it is material information and failure to disclose the Nascent loan is fraud under the Securities Act. Unfortunately, the worst-case scenario for this fraud has played out: Nascent has sued to enforce its rights under its loan agreements and named P-S Investors as defendants.

A third fraud is misuse of investor funds. As noted above, investors understood that their funds would be used only for purchase and development of the property. They did not expect Shudak to take a salary or pay related entities. The evidence presented at hearing shows that, in spite of these representations and in spite of Parker Skylar not generating any profits, on several occasions Shudak made transfers of investor funds that did not benefit CC 1900 or development of the Bisbee Project. The Division showed that on two occasions, Parker Skylar had almost no money in its bank accounts, then received a large payment from an investor. At hearing, the Division's accountant testified—and Shudak did not present any evidence to the contrary—that the majority of funds from these investors did not go to CC 1900 or to development of the Bisbee Project. Representing that funds would be used for one purpose, and then using them for another is a material misrepresentation and constitutes fraud under the Securities Act.

Finally, as discussed above, Parker Skylar represented that it and its manager, Shudak, was capable of raising capital for a significant residential real estate development. But when Shudak discussed his role as the "money-man" of Parker Skylar and raised capital for the Bisbee Project, he omitted information about being sued by his creditors. All but three P-S Investors invested after Shudak was being sued. This information would be material to an investor when ascertaining Shudak's ability to responsibly raise sufficient capital for a major real estate development. Thus, the failure to disclose these lawsuits constitutes a material omission in these offers and violates the antifraud provisions of the Securities Act.

E. Shudak was the Controlling Person of Parker Skylar during the relevant timeframe.

The Division alleged and proved at hearing that Shudak was a controlling person of Parker Skylar pursuant to A.R.S. § 44-1999(B). This provision provides that "Every person who,

directly or indirectly, controls any person liable for a violation of § 44-1991 or 44-1992 is liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act underlying the action." Thus, the Securities Act, "attaches vicarious or secondary liability to "controlling persons" as it does to a person or entity that commits a primary violation of §§ 44–1991 or 1992."[110]

As the Arizona Court of Appeals stated in *Eastern Vanguard Forex Ltd. v. Ariz. Corp. Com'n,* Arizona follows the SEC definition of "control" which is "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."[111]

Here, Shudak directly induced all acts of Parker Skylar, the entity issuing the securities. As noted above, the Division established at hearing that Shudak is the sole manager of Skylar, a manager-managed LLC. Shudak performed all managerial functions for Parker Skylar, including: (1) Locating and communicating with potential investors; (2) Exercising sole control over Parker Skylar's bank account; (3) Exercising control over P-S investor funds; and (4) signing investors' investment documents on behalf of Parker Skylar.

Shudak clearly had the power to control and manage Parker Skylar, and did in fact manage and control it throughout 2008 and 2009 while Parker Skylar sold securities and was actively conducting business (the time-period afterwards did not involve the offer and sale of securities and is irrelevant to the fraud claims in this proceeding). Thus, Shudak is jointly and severally liable with Parker Skylar for the violations of the Securities Act described in this Brief.

F. Numerous offers and sales of the securities.

The final consideration is the number of violations of the Securities Act by Respondents, and the penalty that should be issued. In assessing the administrative penalty, "each violation" carries a penalty, per A.R.S. § 44-2036: an assessment of an administrative penalty may be assessed "in an

[110] *Facciola v. Greenberg Traurig, LLP*, 781 F. Supp. 2d 913, 922-23 (D. Ariz. 2011); *see also Eastern Vanguard Forex Ltd. v. Ariz. Corp. Com'n*, 206 Ariz. 399, 412, 79 P.3d 86, 89 (App. 2003).
[111] 206 Ariz. at 412, 79 P.3d at 89.

amount not to exceed five thousand dollars for each violation." Pursuant to A.R.S. § 44-1841(A), each offer and sale by Respondents was a violation of the Securities Act. As that statute provides: "It is unlawful to *sell or offer for sale* within or from this state any securities unless the securities have been registered...." (emphasis added). Similarly, A.R.S. § 44-1842 provides that "It is unlawful for any dealer to *sell* or purchase or *offer to sell* or buy any securities, or for any salesman *to sell or offer for sale* any securities within or from this state unless the dealer or salesman is registered...." (emphasis added).

The evidence established that Parker Skylar, via its manager Patrick Shudak, offered and sold investments to 14 investors in 22 transactions. Since each offer and each sale involved two securities, a note and an investment contract, this is a total of 88 violations of the registration provisions of the Securities Act. The evidence also established two more violations of the registration provisions, namely, that Shudak offered and sold a note to Donald Van Hook as an investment in Parker Skylar. This is a total of 90 violations involving the offer and sale of unregistered securities.

Further, as shown above, each offer and sale involved fraud. Thus Parker Skylar committed 90 violations of A.R.S. § 44-1991.

Minimally, Shudak, as the control person of Parker Skylar, should be ordered pay an administrative penalty in the amount of $150,000. Given that the Commission could issue a $5,000 fine for the 90 total violations of the registration provisions and another $5,000 for each fraud in connection with the offer and sale of each security, this is substantially less than the maximum penalty that the Commission is authorized to issue.

The Securities Act also provides a remedy of restitution, found in A.R.S. § 44-2032(1). P-S Investors and Van Hook paid Parker Skylar, Shudak or an entity controlled by Shudak a total of $2,142,000.

Notably, at no time prior to the hearing did Shudak provide any evidence showing payments to any of these investors. The Division, however, has identified payments of $25,000, $15,000 and

$15,000 ($55,000 total) to Tim Olp or an entity controlled by Tim Olp, an investor in Parker Skylar. The amounts in these payments could be considered as a legal offset for Respondents.[112]

G. Shudak presented no evidence that an exemption applies.

Unless respondents establish that an exemption applies, the registration provisions of A.R.S. § 44-1841 apply. Under the Securities Act, A.R.S. § 44-2033, the burden of establishing an exemption from registration is upon the party claiming it. In *State v. Baumann*, Arizona's Supreme Court held that, "[b]ecause of the vital public policy underlying the registration requirement, there must be strict compliance with all the requirements of the exemption statute."[113] During the administrative hearing, Shudak failed to establish that the notes and investment contracts offered and sold are exempt from the registration provisions of A.R.S. § 44-1841.

Additionally, even if properly registered or exempt, Shudak and Parker Skylar are subject to the antifraud provisions of the Securities Act. As a result, all fines and conclusions based on fraud would still be applicable.

CONCLUSION

The evidence produced at hearing includes the following:

A. Parker Skylar offered unregistered securities in the form of notes and investment contracts within or from Arizona to offerees;

B. Parker Skylar sold unregistered securities in the form of notes and investment contracts through unregistered dealers or salesmen in or from Arizona to 14 investors and one note-holder totaling $2,142,000;

C. Every offer and sale of the unregistered securities included fraud in connection with the offer and sale of securities by all Respondents;

D. Shudak was the control person for Parker Skylar and as such is jointly and severally liable with Parker Skylar for the restitution and penalties ordered against Parker Skylar.

Based upon the evidence admitted during the administrative hearing, the Division

[112] *See* A.A.C. R14-4-308(C).
[113] 125 Ariz. 404, 411, 610 P.2d 38, 45 (1980) (en banc).

respectfully requests this tribunal to:

1. Order Shudak to pay restitution in the amount of $2,087,000 ($2,142,000 minus $55,000 reflected in payments to Olp), plus pre-judgment interest from the date of each investor's purchase, as set forth in Exhibit S-48, to the date of repayment (interest rate to be calculated at the time of judgment under A.R.S. § 44-1201);

2. Order Shudak to pay an administrative penalty of not more than $5,000 for each violation of the Act, as the Court deems just and proper, pursuant to A.R.S. § 44-2036(A). The Division recommends Shudak pay an administrative penalty in the amount of $150,000.

3. Order Shudak to cease and desist from further violations of the Act pursuant to A.R.S. § 44-2032.

4. Order any other relief this tribunal deems appropriate or just.

RESPECTFULLY SUBMITTED this ___ day of August, 2013.

Ryan J. Millecam
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Arizona Corporation Commission

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